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SUBJECT: 2008 INTERNATIONAL NARCOTICS CONTROL STRATEGY REPORT INCSR
PART TWO, UZBEKISTAN

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11. INTERNATIONAL NARCOTICS CONTROL STRATEGY REPORT VOLUME II REPORT
ON MONEY LAUNDERING

UZBEKISTAN

Uzbekistan is not an important regional financial center and does not have a well-developed financial system. Legitimate business owners, ordinary citizens, and foreign residents generally attempt to avoid using the Uzbek banking system for transactions except when absolutely required, because of the onerous nature of the Government of Uzbekistan's (GOU) financial control system, the fear of GOU seizure of one's assets, and lack of trust in the banking system as a whole. As a result, Uzbek citizens have functioning bank accounts only if they are required to do so by law. They only deposit funds they are required to deposit and often resort to subterfuge to avoid depositing currency. The Central Bank of Uzbekistan (CBU) states that deposits from individuals have been increasing in recent years, but it is still seeking to increase consumer confidence in banks.

Narcotics proceeds are controlled by local and regional drug-trafficking organizations and organized crime. Foreign and domestic proceeds from criminal activity in Uzbekistan are held either in cash, high-value transferable assets, such as gold, property, or automobiles, or in foreign bank accounts.

There is a significant black market for smuggled goods in Uzbekistan. Since the GOU imposed a very restrictive trade and import regime in the summer of 2002, smuggling of consumer goods, already a considerable problem, increased dramatically. Many Uzbek citizens continue to make a living by illegally shuttle-trading goods from neighboring countries and regions, including China, Turkey, Iran, India, Korea, the Middle East, Europe, and the U.S. The black market for smuggled goods does not appear to be significantly funded by narcotics proceeds. It is likely, however, that drug dealers use the robust black market to clean their drug-related money.

Reportedly, the unofficial, unmonitored cash-based market creates an opportunity for small-scale terrorist or drug-related laundering activity destined for internal operations. For the most part, the funds generated by smuggling and corruption are not directly laundered through the banking system but through seemingly legitimate businesses such as restaurants and high-end retail stores. There appears to be virtually no money laundering through formal financial institutions in Uzbekistan because of the extremely high degree of supervision and control over all bank accounts in the country exercised by the Central Bank, Ministry of Finance, General

Prosecutor's Office (GPO), the National Security Service (NSS), and state-owned and controlled banks. Although Uzbek financial institutions are not known to engage in illegal transactions in U.S. currency, illegal unofficial exchange houses, where the majority of cash-only money laundering takes place, deal in Uzbek soum and U.S. dollars. Moreover, drug dealers and others can transport their criminal proceeds in cash across Uzbekistan's porous borders for deposit in the banking systems of other countries, such as Kazakhstan, Russia or the United Arab Emirates.

LEGAL FOUNDATION

Money laundering from the proceeds from drug-trafficking and other criminal activities is a criminal offense. Article 41 of the Law on Narcotic Drugs and Psychotropic Substances (1999) stipulates that any institution may be closed for performing a financial transaction for the purpose of legalizing (laundering) proceeds derived from illicit narcotics trafficking. GOU officials noted that there have been no related cases thus far in Uzbekistan.

Penalties for money laundering are from ten to fifteen years imprisonment, under Article 243 of the Criminal Code. This article defines the act of money laundering to include as punishable acts the transfer; conversion; exchange; or concealment of origin, true nature, source, location, disposition, movement and rights with respect to the assets derived from criminal activity. Although the law has been in effect for more than five years, there is still insufficient information to fully assess the implementation and use of this legislation. Officials from the State Prosecutor's Office reported that Article 243 does not work well because different judges and attorneys can interpret it in different ways.

The CBU, GPO, and the NSS closely monitor all domestic banking transactions to ensure that money laundering does not occur in the banking system. Banks are required to know, record, and report the identity of customers engaging in significant transactions, including the recording of large currency transactions at thresholds appropriate to Uzbekistan's economic situation. All transactions involving sums greater than U.S. \$1,000 in salary expenses for legal entities and U.S. \$500 in salaries for individuals must be tracked and reported to the authorities. The CBU unofficially requires commercial banks to report on private transfers to foreign banks exceeding U.S. \$10,000. Depending on the type and amount of the transaction, banks are required to maintain records for time deposits for a minimum of five years, possibly not sufficient time to reconstruct significant transactions. The law protects reporting individuals with respect to their cooperation with law enforcement entities. However, reportedly, the GOU has not adopted "banker negligence" laws that make individual bankers responsible if their institutions launder money.

A new law to combat money laundering and terrorist financing, passed in 2004, took effect in January 2006. However, in April 2007 the main provisions of the law were suspended by a Presidential decree until January 2013. This means there may not be an effective anti-money laundering law in Uzbekistan for the next five years. The provisions of the law required certain entities to report cash transactions above U.S. \$40,000 (approximately), as well as suspicious transactions. GOU officials claimed that the anti-money laundering law burdened banks and investigators with reporting thousands of benign suspicious transactions that wasted resources on investigations. They reported 17,000 suspicious transactions in a six-month period before the law was suspended compared with 400 in the six months following the suspension of the law. In addition, this law also covered some nonbanking financial institutions, such as investment foundations, depositaries and other types of investment institutions; stock exchanges; insurers; organizations which render leasing and other financial services; organizations of postal service; pawnshops; lotteries; and notary offices. It did not include intermediaries such as lawyers, accountants, or broker/dealers. Casinos are illegal in Uzbekistan.

FINANCIAL INVESTIGATION UNIT / INVESTIGATION

An April 2006 Presidential decree established the Department on Combating Tax, Currency Crimes and Legalizations of Criminal

Proceeds under the GPO. The Department, which the Government of Uzbekistan claims is the functional equivalent of a Financial Intelligence Unit (FIU), is charged with monitoring and preventing money laundering and terrorist financing. It analyzes information received from banks and financial institutions, creates and keeps electronic databases of financial crimes, and, when warranted, passes information to the CBU, tax and law enforcement authorities, or other parts of the GPO for investigation and prosecution of criminal activity. However, given the suspension of the main provisions of the anti-money laundering law in 2007, it is unclear whether there have been any substantial investigations or prosecutions.

The Law on Banks and Bank Activity (1996), article 38, stipulates conditions under which banking information can be released to law enforcement, investigative and tax authorities, prosecutor's office and courts. Different conditions for disclosure apply to different types of clients-individuals and institutions. In September 2003, Uzbekistan enacted a bank secrecy law that prevents the disclosure of client and ownership information for domestic and offshore financial services companies to bank supervisors and law enforcement authorities. In all cases, private bank information can be disclosed to prosecution and investigation authorities, provided there is a criminal investigation underway. The information can be provided to the courts on the basis of a written request in relation to cases currently under consideration. Protected banking information also can be disclosed to tax authorities in cases involving the taxation of a bank's client. Additionally, under the 2006 Presidential decree and subsequent Cabinet of Ministers' resolution on the disclosure of information related to money laundering, it is mandatory for organizations involved in transactions with monetary funds and other property to report such transactions to the GPO's FIU. GOU officials noted that the secrecy law does not apply if a group is on a list of designated terrorist organizations.

Existing controls on transportation of currency across borders

would, in theory, facilitate detection of the international transportation of illegal source currency. When entering or exiting the country, foreigners and Uzbek citizens are required to report all currency they are carrying. Residents and nonresidents may bring the equivalent of U.S. \$10,000 into the country tax-free, and amounts in excess of this limit are assessed a one-percent duty. Customs officers at Tashkent Airport vigorously enforce this limit and target foreign nationals for careful searches as they depart the country. Those caught in possession of more currency than they declared upon entering Uzbekistan are assessed severe fines and may face criminal charges. Residents may export to the equivalent of U.S. \$2,000. Residents wishing to take out higher amounts must obtain authorization to do so; amounts over U.S. \$2,000 must be approved by an authorized commercial bank, and amounts over U.S. \$5,000 must be approved by the CBU. International cash transfers to or from an individual person are limited to U.S. \$5,000 per transaction; there is no monetary limit on international cash transfers made by legal entities, such as a corporation. However, direct wire transfers to or from other Central Asian countries are not permitted; a third country must be used.

International businesses are permitted to have offices in Uzbekistan and are subject to the same regulations as domestic businesses, if not stricter. Offshore banks are not present in Uzbekistan and other forms of exempt or shell companies are not officially present.

The Department of Investigation of Economic Crimes within the Ministry of Internal Affairs (MVD) conducts investigations of all types of economic offenses. A specialized structure within the NSS and the Department on Tax, Currency Crimes and Legalization of Criminal Proceeds is also authorized to conduct investigations of money laundering offenses. Unofficial information from numerous law enforcement officials indicates that there have been few, if any, prosecutions for money laundering under article 243 of the Criminal Code since its enactment in 2001. Officials from the Office of the State Prosecutor reported that there were 11 money laundering-related cases in 2006 and five in 2007. Of these 16 recent cases, officials stated that three are still pending. The status or disposition of the other cases is unknown. As of October 2008 we have not received any additional information about the status of these cases. Overall, the GOU appears to lack a sufficient

number of experienced and knowledgeable agents to investigate money laundering.

TERRORIST FINANCING

Article 155 of Uzbekistan's Criminal Code and the law "On Fighting Terrorism" criminalize terrorist financing. The latter law names the NSS, the MVD, the Committee on the Protection of State Borders, the State Customs Committee, the Ministry of Defense, and the Ministry for Emergency Situations as responsible for implementing the counterterrorist legislation. The law names the NSS as the coordinator for government agencies fighting terrorism. The GOU has the authority to identify, freeze, and seize terrorist assets. Uzbekistan has circulated to its financial institutions the names of suspected terrorists and terrorist organizations listed on the UN 1267 Sanctions Committee's consolidated list and the names of individuals and entities included on the UN 1267 consolidated list. In addition, the GOU has circulated the list of Specially Designated Global Terrorists designated by the United States pursuant to E.O. 13224 to the CBU, which has, in turn, forwarded these lists to banks operating in Uzbekistan. According to the CBU and the Office of the State Prosecutor, no assets have been frozen.

Other than a plan to step up enforcement of currency regulations, the GOU has taken no steps to regulate or deter alternative remittance systems such as hawala, black market exchanges, trade-based money laundering, or the misuse of gold, precious metals and gems. GOU officials noted that most overseas migrants work in more advanced countries such as Russia or Korea where remittances can be easily tracked through financial institutions. We are not aware of any legislative initiatives under consideration. Although officially there is complete currency convertibility, in reality convertibility requests can be significantly delayed or refused. This is particularly the case during the annual autumn cotton harvest, when cash supplies are needed internally to support the extensive mobilization of people and machinery to collect the crop. There are increasing complaints from foreign companies that it is taking well over six months to convert the profits from local sales into foreign currencies in order to transfer the money out of Uzbekistan.

The GOU closely monitors the activities of charitable and nonprofit entities, such as NGOs, that can be used for the financing of terrorism. In February 2004, the Cabinet of Ministers issued Decree 56 to allow the government to vet grants to local NGOs from foreign sources, ostensibly to fight money laundering and terrorist financing. Given the degree of supervision of charities and other nonprofits, and the level of threat Uzbekistan perceives from the Islamic Movement of Uzbekistan (IMU) and other extremist organizations, it is extremely unlikely that the NSS would knowingly allow any funds to be funneled to terrorists through Uzbekistan-based charitable organizations or NGOs.

In February 2008 President Karimov issued a decree offering an amnesty on individual assets in order to bolster confidence in the country's financial sector and banks. Under the amnesty's provisions, money deposited by Uzbek citizens in banks is not subject to taxes, fines or investigations by fiscal authorities. Banks are banned from questioning the origin and source of assets and from releasing the information to law enforcement agencies. The amnesty began April 1, 2008 and is scheduled to expire on April 1, 2009. This decree, in conjunction with the 2007 decrees suspending key elements of the nascent money laundering law, prompted the Financial Action Task Force (FATF) to issue an advisory on Uzbekistan on February 20, 2008. Uzbekistan featured prominently on the agenda of subsequent FATF plenary meetings in London in June 2008 and in Rio de Janeiro in October 2008. Uzbek officials insist that the existing policies and procedures are compliant with the FATF "40 plus 9" recommendations and have offered to meet with the international community to discuss concerns in detail.

Uzbekistan has established systems for identifying, tracing, freezing, seizing, and forfeiting proceeds of both narcotics-related and money laundering-related crimes. Current laws include the ability to seize items used in the commission of crimes such as conveyances used to transport narcotics, farm facilities (except land) where illicit crops are grown or which are used to support

terrorist activity, legitimate businesses if related to criminal proceeds and bank accounts. The banking community, which is entirely state-controlled and with few exceptions, state-owned, cooperates with efforts to trace funds and seize bank accounts. Uzbek law does not allow for civil asset forfeiture, but the Criminal Procedure Code provides for "civil" proceedings within the criminal case to decide forfeiture issues. As a practical matter, these proceedings are conducted as part of the criminal case. We are aware of no new legislation or changes in current law under active consideration by the GOU regarding seizure or forfeiture of assets. The obstacles to enacting such laws are largely rooted in the widespread corruption that exists within the country.

ASSET FORFEITURE

In 2000, Uzbekistan set up a fund to direct confiscated assets to law enforcement activities. In accordance with the regulation, the assets derived from the sale of confiscated proceeds and instruments of drug-related offenses were transferred to this fund to support entities of the NSS, the MVD, the State Customs Committee, and the Border Guard Committee, all of which are directly involved in combating illicit drug trafficking. According to the GOU, a total of 115 million soum (approximately U.S. \$97,000) has been deposited into this fund since its inception. Roughly U.S. \$80,000 has been turned over to Uzbek law enforcement agencies. In 2004, however, the Cabinet of Ministers issued an order to close the Special Fund as of November 1, 2004. Under the new procedure, each agency manages the assets it seizes. There is also a specialized fund within the MVD to reward those officers who directly participate in or contribute to law enforcement efforts leading to the confiscation of property. This fund has generated 20 percent of its assets from the sale of property confiscated from persons who have committed offenses such as the organization of criminal associations, bribery and racketeering. The GOU enthusiastically enforces existing drug-related asset seizure and forfeiture laws. The GOU has not been forthcoming with information regarding the total dollar value of assets seized from crimes. Reportedly, existing legislation does not permit sharing of seized narcotics assets with other governments.

INTERNATIONAL COOPERATION

The GOU realizes the importance of international cooperation in the fight against drugs and transnational organized crime and has made some efforts to integrate the country in the system of international

cooperation. Uzbekistan has entered into agreements with Uzbek bank supervisors to facilitate the exchange of supervisory information including on-site examinations of banks and trust companies operating in the country. Uzbekistan has entered into bilateral agreements for cooperation or exchange of information on drug related issues with the United States, Germany, Italy, Latvia, Bulgaria, Poland, China, Iran, Pakistan, the Commonwealth of Independent States (CIS), and all the countries in Central Asia. It has multilateral agreements in the framework of the CIS, under the Shanghai Cooperation Organization, and under memoranda of understanding. An "Agreement on Narcotics Control and Law Enforcement Assistance" was signed with the United States on August 14, 2001, with two supplemental agreements that came into force in 2004.

Uzbekistan does not have a Mutual Legal Assistance Treaty with the United States. However, Uzbekistan and the United States have reached informal agreement on mechanisms for exchanging adequate records in connection with investigations and proceedings relating to narcotics, terrorism, terrorist financing and other serious crimes. In the past, Uzbekistan has cooperated with appropriate law enforcement agencies of the USG and other governments investigating financial crimes and several important terrorist-related cases. Cooperation in these areas became increasingly problematic in an atmosphere of strained U.S.-Uzbekistan bilateral relations, but there was a gradual improvement in 2008. Uzbekistan joined the Eurasian Group on Combating Money Laundering and the Financing of Terrorism (EAG), a FATF-style regional body, at the group's December 2005 plenary meeting. High-level officials from the Government of Uzbekistan attended the EAG's plenary meeting in Kyrgyzstan in July 2008 to defend its existing anti-money laundering measures amidst growing international attention to Uzbekistan following the suspension of key elements of the law and the deposit amnesty

decree. The EAG then conducted an evaluation of Uzbekistan in September 2008, which produced a mixed assessment on the effectiveness of Uzbekistan's anti-money laundering policies.

The GOU is an active party to the relevant agreements concluded under the CIS, the Central Asian Economic Community (CAEC), the Economic Cooperation Organization (ECO), and the Shanghai Cooperation Organization. Uzbekistan is a party to the 1988 UN Drug Convention, the UN International Convention for the Suppression of the Financing of Terrorism, and the UN Convention against Transnational Organized Crime. Uzbekistan adopted the UN Convention against Corruption on July 8, 2008.

A lack of trained personnel, resources, and modern equipment continues to hinder Uzbekistan's efforts to fight money laundering and terrorist financing. Moreover, the April 2007 decree suspending the main provisions of the money laundering law until 2013 and the February 2008 Presidential decree providing an amnesty on deposits were seen in the international community as major setbacks. FATF issued a statement on October 16, 2008 calling for urgent action to address the vulnerability posed by Uzbekistan's deficient AML/CFT regime and called on its members to strengthen preventive measures to protect their financial sectors from this potential risk. The statement also added that both FATF and the EAG are "prepared to engage directly in assisting Uzbekistan in developing a robust AML/CFT regime." The GOU should rescind this decree, reinstating the provisions of the law, while continuing to refine its pertinent legislation to bring it into conformity with international standards. Additional refinements should expand the cross-border currency reporting rules to cover the transfer of monetary instruments, and precious metals and gems. Access to financial institution records should be given to appropriate regulatory and law enforcement agencies so that they can properly conduct compliance examinations and investigations. While the establishment of an FIU was a positive step in 2006, much will depend, in the future, on the unit's ability to effectively cooperate with other GOU law enforcement and regulatory agencies in receiving and disseminating information on suspicious transactions. In the short term, FIU operations will depend on whether there is any incoming reporting activity at all, given the suspension of the law.

NORLAND